

RISK RETENTION AMENDMENTS OF 1986

MAY 9, 1986.—Ordered to be printedFiled, under authority of the order of the Senate of May 8 (legislative day, May 5),
1986Mr. DANFORTH, from the Committee on Commerce, Science, and
Transportation, submitted the following

REPORT

together with

ADDITIONAL AND MINORITY VIEWS

[To accompany S. 2129]

The Committee on Commerce, Science, and Transportation, to which was referred the bill (S. 2129) to facilitate the ability of organizations to establish risk retention groups, to facilitate the ability of such organizations to purchase liability insurance on a group basis, and for other purposes, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill do pass.

PURPOSE OF THE BILL

S. 2129, as reported, is a response to one aspect of the overall liability insurance problem: the unavailability and high cost of liability insurance. The bill addresses this aspect of the problem by expanding the application of the Product Liability Risk Retention Act of 1981, Public Law 97-45 (15 U.S.C. 3901 et seq.), (the "Risk Retention Act") in order to permit others, besides product manufacturers, sellers, and distributors, to purchase their liability insurance on a group basis or to self-insure through insurance cooperatives called "risk retention groups."

This bill amends the Risk Retention Act to provide an opportunity for other related or similarly situated businesses and groups, such as municipalities, schools, professionals, directors and officers,

and nonprofit organizations, to form purchasing groups or risk retention groups in order to reduce their insurance costs or to obtain coverage that is not available from commercial insurance underwriters. Today, many of these groups have had favorable claims experience, which they believe is not reflected in their rates; some cannot obtain any coverage at all. Further, like the risk Retention Act, this bill is intended to promote greater competition among general liability insurers by encouraging them to set premiums which are competitive with those charged by risk retention groups.

BACKGROUND AND NEEDS

THE PRODUCT LIABILITY RISK RETENTION ACT OF 1981

The Committee has had a longstanding interest in the availability and cost of liability insurance. In 1981, Congress enacted the Product Liability Risk Retention Act of 1981, which was reported by the Committee as S. 1096. This bill was enacted to facilitate the ability of businesses to purchase product liability insurance on a group basis and to establish self-insurance coverage on a group basis for product liability risks. It does this by preempting certain duplicative and overlapping State laws, which have restricted the formation of such groups.¹

Risk retention legislation first had been considered by the Committee as a response to the high cost and unavailability of product liability insurance in the late 1970's. In its report on the 1981 legislation, the Committee recognized that the product liability insurance market had stabilized and that availability was no longer a problem; however, the Committee noted that product manufacturers and distributors, small and large, continued to believe that product liability insurance costs were too high and that the insurance industry was not being responsive to the actual claims experience of product manufacturers and distributors.

The 1981 Committee report noted that product liability insurance rates are generally developed through the exercise of underwriting judgments that are not set solely by actuarial techniques and that the ratemaking process has been complicated by judicial decisions, beginning in the 1960's and continuing throughout the 1970's, which had increased the potential liability of product manufacturers and sellers. The Committee recognized that in such circumstances many insurance companies were unable to project future claims experience and were using subjective ratemaking techniques, which resulted in both a refusal to provide coverage and extremely high costs for such coverage. The Risk Retention Act was adopted by the Committee as a response to this ratemaking problem that would increase competition in the product liability sector of the insurance industry.²

¹ In 1983, Congress enacted Public Law 98-193, which amended section 2(b) of the Risk Retention Act to clarify the scope of the law with respect to the definition of "product liability" coverage that risk retention groups and purchasing groups may provide. This measure, which was reported by the Committee as S. 1046, clarifies that the term "product liability" is to be given a broad interpretation to facilitate the operation of risk retention groups and purchasing groups in order to permit them to insure any product liability risks. See S. Rept. 98-172, pp. 2-3.

² S. Rept. 97-172, page 2.

The Risk Retention Act was thus adopted by the Committee to help assure that insurance rates and premiums are set on a competitive basis. That act accomplished this by preempting State law to the extent necessary to facilitate the establishment of collective purchasing groups and interstate self-insurance groups for product liability and completed operations liability coverage.³

With respect to this preemption, the Committee took note of the fact that certain State laws hinder the formation and operation of association captive insurance companies or "risk retention" groups, and that the principal problems arise not from an inability to create a captive insurance company in one jurisdiction, but from regulatory restrictions on the ability of such captive to operate among the several States.

This preemption of State law is central to the Risk Retention Act's objective of facilitating the efficient operation of risk retention groups by eliminating the need for compliance with numerous non-chartering State statutes that, in the aggregate, would thwart the interstate operation of product liability risk retention groups. Under the Risk Retention Act, a product liability risk retention group must obtain a charter from only one State, or before January 1, 1985, from the nations of Bermuda or the Cayman Islands. Non-chartering States remain free to collect premium taxes on a non-discriminatory basis. They also remain free to impose key regulations designed to protect consumers, such as fair claims practices procedures, requirements as to residual market mechanisms, examination to determine financial condition and delinquency proceedings. On the other hand, multiple capitalization requirements and other regulations that impede the formation of interstate self-insurance groups are preempted. These include requirements as to participation in an insurance insolvency guaranty organization to which an insurer licensed in a State is required to belong, requirements as to countersignatures by agents or brokers residing in a State, and other requirements that discriminate against a risk retention group or its members.⁴

Moreover, the Risk Retention Act provides that the responsibility for regulatory supervision of a risk retention group rests with the commissioner of the chartering jurisdiction. As explained in the Committee report (S. Rept. 97-271, page 13):

Because risk retention groups will be providing insurance coverage only to their members, and not to the public at large, it is believed that regulation by the chartering jurisdiction will be sufficient to provide adequate supervi-

³ "Completed operations liability," as defined by section 2(a)(1) of the Risk Retention Act, means liability arising out of the installation, maintenance, or repair of any product at a site which is not owned or controlled by any person who performs that work or any person who hires an independent contractor to perform that work. Such liability arises only from operations which have been completed or abandoned. The Committee chose to include such liability coverage in the Risk Retention Act, because "product liability and completed operations coverage are so closely related that they are routinely sold in one package by commercial insurers either as an endorsement to, or as part of, the standard comprehensive general liability package." S. Rept. 97-172, page 7.

⁴ Except for the antifraud provisions of the Securities Act of 1933 (15 U.S.C. 77a et seq.), the Risk Retention Act also exempts risk retention groups from Federal and State securities laws. As the Committee explained (S. Rept. 97-172, page 4): "Since ownership interests in risk retention groups will not be sold to the public, making them comply with Federal and State securities laws is unnecessary."

sion of these groups. In addition, regulation by a single commissioner is essential to the elimination of duplicative and conflicting regulatory requirements of different states.

In addition, the Risk Retention Act was formulated by the Committee to permit the collective purchasing of product liability coverage, completed operations coverage, and comprehensive general liability coverage containing either or both of these coverages on a group basis. Because the group purchase of general liability insurance is prohibited or restricted by a majority of states, the act preempts such group purchases from those restrictive laws and other laws that prohibit insurers from giving preferential rates, terms, and conditions to groups seeking product liability and related insurance coverage.

THE PRESENT LIABILITY INSURANCE CRISIS

Today in 1986, the liability insurance crisis is more widespread and cuts across many lines of liability insurance. Ratemaking is not the only concern; unavailability of coverage is a major problem along with the high cost of insurance. At the present time, some manufacturers, service industries, municipal governments, truckers, hazardous waste disposers, day-care providers, commercial fishing vessel operators, restaurant and tavern owners, resort operators, corporate directors and officers, nurse-midwives, physicians, architects, and other professionals find themselves facing huge premium increases for liability insurance. Some have had their coverage cancelled or have faced reduced coverage with increased deductibles. Others cannot obtain liability coverage at any price.

The scope and extent of the liability insurance crisis has been well documented before the Committee. In a number of subcommittee hearings, testimony has been presented about the impact of the tightening liability insurance market on such industries as trucking, fishing, and commercial satellite development.

Most recently, on February 19 and March 4, full Committee hearings were held to conduct a more comprehensive examination of the availability and cost of liability insurance. At these hearings, testimony was presented which showed that cost and availability problems are not limited to a few lines of coverage and that commercial insurance companies are sometimes unable to provide needed coverage or unwilling to offer adequate liability insurance coverage except at extremely high, unaffordable rates that are not always related directly to actual claims experience.

Witnesses noted that the insurance crisis has arisen during a period of falling interest rates, prior to which competing insurance companies had been underpricing their product in order to maximize cash flow and enhance investment income. When interest rates began to fall, companies were forced to increase premiums because investment income was no longer compensating for underwriting losses. This practice of "cash flow underwriting" was linked directly to the current crisis. Some witnesses also cited the role of increasing claims losses and the rising cost of litigation in contributing to the crisis.

At these hearings, expansion of the Risk Retention Act was proposed by a number of witnesses. They described in detail their diffi-

culties in obtaining liability insurance and self-insuring under conflicting State laws; they expressed the view that broader Federal preemption of State law is required to permit others besides those seeking product liability coverage to self-insure on a multistate basis and to collectively purchase liability insurance.

The Committee's view of the current liability insurance crisis is supported by the administration's Tort Policy Working Group in its recent report on insurance availability and affordability. As the report states:

Liability insurance is a linchpin in the operation of the U.S. economy, yet many American businesses, professionals and municipalities, both large and small, are encountering serious insurance problems arising from premium increases, policy cancellations and refusals to underwrite certain activities. * * * Where insurance is available (and in some areas it simply is not), premium increases of several hundred percent over the last year or two have become commonplace. Few if any private or public entities that rely on liability insurance have escaped the problems generated by this crisis.⁵

The Committee believes that expansion of the Risk Retention Act is an appropriate response to this crisis in both the pricing and availability of liability insurance. The policy underlying that act is applicable to other lines of liability coverage and the broad scope of the problem warrants expansion of that act to facilitate group insurance program that reduce costs and provide alternative mechanisms for coverage in all lines of general liability insurance.⁶

Federal action is warranted, because the existence of affordable and readily available liability insurance is vital to the operation of the economy. Without such coverage, consumers pay higher prices for essential goods and services; those with legitimate claims are left uncompensated; professional services are curtailed; jobs are lost, and taxes go up as local governments are forced to pay higher premiums for their municipal liability insurance. Moreover, the lack of affordable and available insurance hinders the development of new enterprises and technology and weakens the Nation's position in world trade.

In addition, the commercial insurance market has not demonstrated that it has sufficient capacity to insure all enterprises. A means must be found to permit those seeking liability insurance coverage to do so on a more competitive basis and to mobilize their own capital to assume and spread their liability risks.

⁵ Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability, February 1986, pp. 1, 6.

⁶ As noted in the administration's Tort Policy Working Group report (page 59):

One reason that the [Risk Retention Act] has been little used is the fact that it is limited to products and completed operations coverages, although groups may include other coverages as long as products is the primary purpose. It is a useful means of expanding insurance capacity, and would provide additional capacity in the alternative market if the products limitation is removed.

LEGISLATIVE HISTORY

S. 2129 was introduced by Senator Kasten, with Senators Danforth, Hollings, and Rockefeller as cosponsors, on February 28, 1986. A hearing on this measure was held by the Consumer Subcommittee on March 20, 1986. At this hearing testimony was received from the following groups and individuals: the American Insurance Association; the Independent Insurance Agents of America; the Professional Insurance Agents; the National Association of Casualty & Surety Agents; Crum and Forster Insurance Companies; the National Association of Independent Brokers; Michael J. Mullen, Esq.; the American College of Nurse-Midwives; the Risk Insurance Management Society, Inc.; the National Rural Electric Cooperative Association; and the National Association of Insurance Commissioners.

After the hearing, the bill was revised to address concerns that had been raised by witnesses.⁷ These concerns included such matters as the scope of the legislation, and the need to assure that insurance regulators in non-chartering States have sufficient authority with respect to fraudulent practices by risk retention and purchasing groups, improper sales to the general public by such groups, and the financial condition of such groups. The revisions were incorporated in an amendment in the nature of a substitute which was offered by Senator Kasten and adopted by the Committee, with modifications, when the bill was ordered favorably reported on March 27, 1986. Additional cosponsors of S. 2129 are Senators Pressler, Gore, Sasser, Kassebaum, Simon, Inouye, Weicker, and Sarbanes.

SUMMARY OF MAJOR PROVISIONS

As reported, S. 2129 amends the Risk Retention Act to permit the formation of purchasing and risk retention groups for other liability insurance coverage in addition to product liability and completed operations liability. Liability insurance coverage is defined in the bill to cover all liability insurance, except for workers' compensation, employers' liability insurance, and "personal risk insurance." "Personal risk insurance" means homeowners, tenant, private passenger non-fleet automobile coverage, and other liability and casualty insurance primarily for personal, family, or household needs rather than for business or professional needs.

S. 2129 specifies that the authority to offer or provide insurance under this bill is limited to liability insurance. It states that the Risk Retention Act does not authorize a risk retention group or a purchasing group to provide coverage of any other line of insurance.

This measure allows associations, businesses, corporations (whether for-profit or not-for-profit), professional groups, churches, schools, universities, hospitals, and other institutions, as well as State or local government entities, to form such groups. The mem-

⁷ At the hearing, there was also discussion of an insurance industry proposal to require a risk retention group to demonstrate the unavailability of insurance coverage in each State in which it seeks to provide coverage to its members. Witnesses testifying in opposition to this proposal stated that it would be a superfluous, unnecessary burden that would undermine the purposes of the legislation.

bers of such groups must be similarly situated or related with respect to the nature of their exposure to the risk of liability.⁸

These 1986 amendments make a few changes in the overall regulatory framework of the Risk Retention Act. It still would preempt to the extent necessary those State laws that prevent or hinder association captive insurance companies licensed in the State from providing coverage for its members in other States, and that restrict the operation of purchasing groups. New risk retention groups would have to be chartered or licensed as liability insurance companies under the laws of a State, and would be exempt, except for certain activities, from regulation by other States in order to permit them to operate without duplicative or overlapping regulation.

S. 2129 does expand the authority of State insurance commissioners in non-chartering States to conduct a financial examination of a risk retention group and to institute a delinquency proceeding and enforce a lawful order in such a proceeding, if there has been a finding of financial impairment by the insurance commissioner of any State. In addition, this bill amends the Risk Retention Act to give non-chartering States authority to enjoin the following conduct: (1) improper solicitation or sale of purchasing group or risk retention group insurance coverage to the general public; (2) false, deceptive or fraudulent acts or practices involving the sale or solicitation of such coverage, or other fraudulent conduct involving such groups; and (3) the sale or solicitation of such insurance coverage or the operation of such groups when they are in a hazardous financial condition.

ESTIMATED COSTS

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate and section 403 of the Congressional Budget Act of 1974, the Committee provides the following cost estimate, prepared by the Congressional Budget Office:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 22, 1986.

Hon. JOHN C. DANFORTH,
*Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Dirksen Senate Office Building, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 2129, the Risk Retention Amendments of 1986, as ordered reported by the Senate Committee on Commerce, Science, and Transportation, March 27, 1986.

This bill amends the Product Liability Risk Retention Act of 1981 (Public Law 97-45) to extend many of the provisions of that law to cover groups wanting general liability insurance. That law preempted many state laws regulating product liability insurance

⁸ It should be noted that nothing in this bill or the Risk Retention Act is to be construed to provide any immunity or defense to any action under the antitrust laws for any risk retention group or group members. Nor does this measure amend the McCarran-Ferguson Act (15 U.S.C. 1011-15), which provides the "business of insurance" immunity from Federal antitrust laws to the extent such business is "regulated by State law." See S. Rept. 97-172, pp. 15-16.

for groups wishing to self-insure or collectively purchase product liability insurance, but gave state insurance commissioners the authority to examine any group's financial condition if there was an indication of financial impairment. S. 2129 makes the same provisions applicable to groups wishing to purchase or self-insure for general liability coverage, thereby making it easier for professional, business, and government organizations to self-insure or form collective purchasing groups for general liability insurance coverage. This bill is not expected to affect the federal government and no federal budget impact is expected.

A state oversight system was created in response to Public Law 97-45. Although we expect that state governments will realize some additional oversight responsibility as a result of S. 2129, the additional regulatory costs to states are not expected to be significant.

Under the provisions of this bill, state and local governments and government agencies are allowed to form risk retention or purchasing groups for acquisition of general liability insurance coverage. If governments or government agencies choose to do so, they would incur associated development costs, but over time would expect to realize some savings relative to the cost of purchasing from commercial insurance carriers. In the near term, any costs associated with formation of insurance acquisition groups are not expected to be significantly different from the cost of existing insurance coverage.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,

Sincerely,

RUDOLPH G. PENNER, *Director*.

REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee provides the following evaluation of the regulatory impact of the legislation.

The bill creates no Federal regulatory authority and will have no Federal regulatory impact. The bill does subject new risk retention groups to the jurisdiction of the Securities and Exchange Commission for purposes of monitoring and enforcing antifraud statutes. It is expected that no significant additional cost would be incurred as a result of this provision.

This legislation is not likely to affect substantially the privacy of individuals or paperwork requirements.

SECTION-BY-SECTION ANALYSIS

SECTION 1.—SHORT TITLE

This section contains the short title of the bill, which is the "Risk Retention Amendments of 1986".

SECTION 2.—TITLE OF THE ACT

This section changes the title of the Product Liability Risk Retention Act of 1981. It amends section 1 of the Risk Retention Act

to provide that it may be cited as the "Liability Risk Retention Act of 1986."

SECTION 3.—DEFINITIONS

This section amends the definitions and terms contained in section 2 of the Risk Retention Act to expand that act's application to other types of liability coverage in addition to product liability; moreover, it expands the definition of those who are eligible to form risk retention and purchasing groups to include others besides product manufacturers, sellers, and distributors.

Section 3(a) of the bill strikes the Risk Retention Act's definitions of "completed operations liability" and "product liability." It replaces these terms with a new, broad definition of "liability insurance." "Liability insurance" is defined as insurance covering an organization's legal liability for damages because of injuries to other persons, damage to their property, or other loss or damage to such other persons arising out of its business, trade, products, services (including professional services), premises or operations, but does not include (A) personal risk insurance or (B) workers' compensation and employers' liability insurance. The term "legal liability" as used in the definition of "liability insurance" includes liability that is assumed in a contract, agreement or warranty that is an "insured contract" or liability that the insured would have in the absence of such a contract.

"Liability insurance" includes general liability, business automobile liability, contractual liability, owners, landlord and tenants liability, completed operations and product liability (including coverage for damage to work performed and damage to a product itself, if covered under a policy), directors' and officers' liability, professional liability, pollution liability (including coverage for damages caused by both sudden and non-sudden releases of pollutants), and other forms of liability insurance that provide coverage for the legal liability of an insured person for damages incurred by others. This term also includes homebuilders and sellers warranty insurance, which came within the scope of the Risk Retention Act's definition of product liability and similarly is intended to come within the definition of liability insurance contained in this bill. See S. Rept. 97-172, page 8.

"Liability insurance" does not include "personal risk insurance" because this bill is intended to cover the legal liability of businesses, State and local government entities, professionals, associations, and nonprofit organizations, but not individuals with respect to non-business risks or private, non-professional risks. Workers' compensation and employers' liability insurance also is excluded from the definition of "liability insurance" for the purposes of this bill because there is not, at the present time, a problem regarding the availability and affordability of workers' compensation insurance.

Section 3(a)(3) of the bill defines "organization" as any association, business, corporation (whether for-profit or not-for-profit), professional corporation or partnership (including individual practitioners, such as nurse-midwives, with respect to their business or professional activities), church, hospital, school, university, or other institution or a State or local government (or any agency of such a

government). This definition is intended to be construed broadly to include any corporation, business or firm, any professional group, and any nonprofit organization or State or local government entity.

Section 3(a)(3) defines "personal risk insurance" as homeowners, tenants, private passenger non-fleet automobile, mobile home, and other liability and casualty insurance primarily for personal, family and household needs, rather than for business and professional needs. As previously explained, this bill is intended to facilitate self-insurance programs and the group purchase of liability insurance for businesses and nonprofit organizations. Individual persons (other than professionals with respect to their professional liability risks) cannot obtain insurance coverage for their private passenger automobile or homeowner liability insurance through a risk retention group or a purchasing group.

Section 3(a)(4) of the bill expands the Risk Retention Act's definition of a "risk retention group" to allow such groups to assume and spread all, or any portion, of members' other liability risks, besides product liability and completed operations liability.⁹ In addition, this section of the bill provides that such groups must be chartered or licensed as an insurance company and authorized to engage in the business of insurance under the laws of any State. The policy here remains that underlying the Risk Retention Act. As the Committee explained in its 1981 report (S. Rept. 98-172, page 9):

The place of incorporation or formation of the risk retention group does not have to be the place of chartering. . . . However, for the purposes of this act, the jurisdiction in which the risk retention group is chartered as an insurer is intended to govern its status as an insurer in other jurisdictions (including the place of incorporation or formation, if that State is not the jurisdiction from which it received its charter as an insurer.) Thus, it is intended that the chartering jurisdiction can apply the full panoply of its insurance laws regarding the organization and operation of the company (e.g., minimum capitalization, reporting, audits, etc.) to the group.

This section does not provide for the chartering of risk retention groups by off-shore jurisdictions, although the Risk Retention Act did allow such groups to be chartered under the laws of any State or, before January 1, 1985, under the laws of Bermuda or the Cayman Islands, if they met the minimum capitalization requirements of at least one State. The Committee has not chosen to allow new groups to utilize such off-shore jurisdictions; however, as amended further by the Committee, this provision clarifies that this legislation does not affect those product liability risk retention groups that were chartered or licensed before January 1, 1985, under the laws of Bermuda or the Cayman Islands and that had met the capitalization requirements of one State. Such risk retention groups may continue to operate and to provide insurance to

⁹ It should be noted that this provision allows a risk retention group to maintain a claims settlement program for risks within a policyholder's deductible, if the program is for liability risks that could be insured under this Act.

cover product liability or completed operations liability, as such terms were defined in the Risk Retention Act.

Section 3(a)(4)(D) provides that the members of a risk retention group must be persons "whose members, businesses or activities are similar or related with respect to the nature of their exposure to the risk of liability stemming from any business, trade, product, services, premises, or operations which are related, similar or common to such members." This subparagraph thus amends the provision of the Risk Retention Act that limited membership in risk retention groups to those businesses that were primarily engaged in the manufacture, design, importation, distribution, packaging, labeling, leasing, or sale of a product.

It is the intent of the Committee that the Risk Retention Act should be broadly construed to carry out its purpose; however, the purpose of this provision is to assure that there is some similarity or relationship with respect to the liability risks of organizations which are members of a risk retention group, and to prohibit the use of a single self-insurance pool or risk retention group to insure completely unrelated risks. This was a concern raised by a number of witnesses at the hearing on this bill, and this language was adopted by the Committee as an amendment to the original bill in order to address this concern.

The Committee considers it important that the members of a risk retention group must be similarly situated or related with respect to the nature of their exposure to the risk of liability. For example, the professional liability exposure of nurse-midwives is not considered "similar or related" to the product liability exposure of machine tool builders or the exposure of a hazardous waste producer. Likewise, the general liability risks of trucking companies and restaurants are not considered similar or related.

On the other hand, however, a group which consisted of aviation product manufacturers and firms which serviced and repaired their products would be considered a group whose risks are related with respect to liability stemming from their businesses, products and services, and therefore they would be authorized to form a group under section 2(a)(5)(E) of the Risk Retention Act, because their liability arises out of similar or related businesses, products, or services. Similarly, a group which included manufacturers of amusement park rides and the operators of such equipment would be considered to have a related exposure to liability. It is consistent with the requirements of this section to allow the formation of groups with related risks because such groups may jointly engage in loss prevention programs which will bring about an overall reduction in losses and because they may face similar problems in procuring adequate liability coverage.

With respect to directors' and officers' insurance, firms or organizations with similar risks are authorized to be members of a group. For example, a group of manufacturers would generally be considered to have similar or related exposure to directors' and officers' liability, but their risks might be different from those of banks and other financial institutions, and they would not be able to pool their risks with those of the directors and officers of such financial institutions. In addition, nonprofit organizations could establish a risk retention group to provide directors' and officers' liability in-

insurance coverage. As for pollution liability coverage, a group of companies engaged in the transportation, treatment, or storage of hazardous wastes would be eligible to form a risk retention group.

Section 3(a)(5) of the bill amends the Risk Retention Act's definition of a "purchasing group." A purchasing group is any group of persons which has as one of its purposes the purchase of liability insurance on a group basis, and whose members, business, or activities are similar or related with respect to the nature of their exposure to the risk of liability, etc. This requirement is identical to that imposed for risk retention groups in section 3(a)(4)(D) of the bill, and it is the intention of the Committee that it should be interpreted in the same manner as the requirement regarding related risks set forth for risk retention groups. On the other hand, the Risk Retention Act clearly supersedes other restrictions arising under State law that prohibit or limit the establishment of such groups and the ability of insurers to offer liability insurance on a group basis.

Section 2(b) of the Risk Retention Act provides that that nothing in it shall be construed to affect either the tort law or the law governing the interpretation of insurance contracts of any State, and that the definitions of product liability and product liability insurance under any State law shall not be applied for the purposes of the Risk Retention Act, including recognition or qualification of risk retention groups or purchasing groups. Section 3(b) of the bill amends this provision to make State law definitions of liability insurance and personal risk insurance inapplicable for the purposes of the Risk Retention Act, including recognition or qualification of risk retention groups or purchasing groups.

Section 3(c) of the bill adds two provisions to the Risk Retention Act. The first provides that that act shall not be construed to exempt a risk retention group or a purchasing group authorized under the Risk Retention Act from the policy form or coverage requirements mandated under any State no-fault automobile insurance law. For example, a risk retention group and a purchasing group are required to meet the first party coverage requirements of any such State law.

The second provides that the authority to provide insurance under the Risk Retention Act is limited to liability insurance, and that Risk Retention Act does not authorize a risk retention group or a purchasing group to provide coverage of any other line of insurance. This provision simply reaffirms and clarifies the intent of Risk Retention Act that risk retention and purchasing groups only offer or purchase insurance coverages authorized by the Risk Retention Act, and may not provide or purchase coverage for life insurance, health insurance, or other lines of insurance for their members.

SECTION 4.—RISK RETENTION GROUPS

This section of the bill amends the language of section 3 of the Risk Retention Act, which defines the scope of the preemption of State law required for the formation and interstate operation of risk retention groups. This amendment expands the application of

the exemptions from State laws, rules, and regulations set forth in this section to include all "liability insurance" coverage provided by a risk retention group for such group or any person who is a member of such a group, as well as the sale of liability insurance coverage for a risk retention group or any member of such group. These exemptions are also applicable to the provision of insurance-related services or management services for a risk retention group or any member of such a group.

In addition, section 3(a)(1)(F) of the Risk Retention Act is amended to broaden the authority of a State insurance commissioner in a nonchartering State where the group is doing business to conduct an investigation of the group's financial condition. Under existing law, a commissioner may conduct an investigation only if he or she has reason to believe the risk retention group is in a financially impaired condition and if the commissioner of the jurisdiction in which the group is chartered has not begun or has refused to initiate an examination of the group. This provision is amended to delete the requirement that an insurance commissioner must have reason to believe that the risk retention group is in a financially impaired condition.

However, a new requirement has been added that any such examinations by State insurance commissioners must be coordinated to avoid duplication and unjustified repetition. Thus, in accordance with this requirement, the State insurance commissioner in any State in which a risk retention group is doing business may examine the financial condition of the group if the chartering State has not begun or has refused to begin such an examination.

In addition, section 3(a)(1)(G) of the Risk Retention Act is amended by striking the requirement that the commissioner of the chartering jurisdiction must be given notice of a finding of financial impairment by the examining State and that the chartering State must then fail to initiate a delinquency proceeding before the examining State may do so. This amendment thus allows the commissioner of any State to institute a delinquency proceeding if there has been a finding of financial impairment, pursuant to the Risk Retention Act, and requires a risk retention group to comply with a lawful order issued in such a delinquency proceeding.¹⁰

It is in response to legitimate concerns expressed at the hearing on S. 2129 that the Committee has adopted these provisions as amendments to the original bill. Their purpose is to assure that State insurance commissioners have adequate authority to supervise the solvency of risk retention groups. However, the Committee intends and expects this authority will be utilized in an appropriate manner and not to impose unjustified burdens on legitimate, adequately funded risk retention groups that meet the financial re-

¹⁰ As the Committee explained in its report on the Risk Retention Act (S. Rept. 97-172, page 14):

A "lawful order issued in a delinquency proceeding" means such orders as a commissioner has reasonable cause to believe are reasonably necessary to correct, eliminate, or remedy any act, practice or transaction by a risk retention group that would subject it, under the laws of his State, to a proceeding for the purpose of its liquidation, rehabilitation, reorganization or conservation; and any order issued by a court of competent jurisdiction in a State in a formal delinquency proceeding initiated by a commissioner against such a group.

quirements of their chartering States and that are not in a hazardous financial condition.

This expanded authority with respect to examinations and delinquency proceedings should not be used as a pretext for forcing risk retention groups to comply, for example, with capital and surplus requirements that may be substantially higher than those in the chartering jurisdiction. It should not be used to harass small risk retention groups for whom the cost and administrative burdens of an examination could be prohibitive. Moreover, a delinquency proceeding should only be initiated when a risk retention group is in such condition as to render the continuation of its business in that jurisdiction financially hazardous to its creditors or holders of its policies or certificates of insurance.

Section 3 of the Risk Retention Act is amended further to add a new subsection (d) which provides that nothing in this section shall be construed to affect the authority of any State to enjoin a number of practices by risk retention groups that could be detrimental to the public. This new subsection is intended to address the concern of the National Association of Insurance Commissioners, expressed at the hearing, that if the scope and application of the Risk Retention Act is expanded, State insurance regulators must have adequate authority to enjoin fraudulent activities, improper sales to the general public, and the operation of risk retention groups that are on the brink of insolvency or that are being operated in a manner that threatens insolvency.

Paragraph (1) of this new subsection states that section 3 of the Risk Retention Act shall not be construed to affect the authority of any State to enjoin the sale or solicitation of coverage by a risk retention group to the public or any person who is not eligible for membership in such group. This provision is intended to prevent promoters from selling insurance to the public at large while operating under the guise of a risk retention group's exemption from nonchartering State insurance laws. The purpose of this language is to allow State insurance commissioners to enjoin sham operations and to protect unwary consumers who are not eligible for membership in the group offering them coverage. It is not intended to limit the ability of a risk retention group to solicit those organizations or persons who are eligible to join the group.

In addition, paragraph (2) of new subsection (d) allows a State insurance commissioner to enjoin false, deceptive or fraudulent acts or practices in the solicitation or sale of insurance to a member or prospective member of a risk retention group, or other fraudulent conduct by any such group. This provision is intended to allow State insurance commissioners to enjoin the promoters or organizers of a risk retention group from engaging in sales activities which are false, deceptive or fraudulent in some material aspect and which will result in defrauding potential members of a group. It is not intended to allow State insurance departments to apply every local regulation regarding the sale of insurance to the materials or conduct of a risk retention group which is, in fact, truthful and not deceptive and is understood by the persons or organizations being solicited for membership in a group.

With respect to other fraudulent conduct, the Committee's concern is conduct which involves deceit, trickery or misrepresenta-

tion, or the intentional perversion of truth in order to induce a member or prospective member of a risk retention group to give up something of value without receiving a commensurate benefit in terms of coverage, or other aspects of a risk retention group program.

Paragraph (3) of new subsection (d) allows an insurance commissioner in any State in which a risk retention group is operating to enjoin the solicitation or sale of insurance by, or the operation of, a risk retention group that is in a "hazardous financial condition." As noted above, the Committee intends that the primary responsibility for regulating the financial condition of a risk retention group rest with the State in which the group is licensed or chartered. Thus, there is a presumption that if the group meets the reserve requirements and other financial conditions of the licensing State it is in a sound financial condition. To assure, however, that plainly and demonstrably under-reserved or under-capitalized organizations do not operate and cause harm to group members and the general public, the insurance commissioner in each State in which a group operates is given authority to enjoin its operation if there is a finding that the group is in a hazardous financial condition.

The Committee has given State insurance commissioners this added authority to prevent and prohibit unsound and hazardous operations, not to interfere with legitimate, adequately funded groups. This provision is intended to address the concern that a risk retention group in a "hazardous financial condition" will continue to operate because of a failure of the commissioner of the chartering jurisdiction to exercise adequate regulatory supervision.

Whether a group is in a hazardous financial condition is to be determined in accordance with general actuarial principles for determining loss reserves, capital, and surplus, and not the capital and surplus requirements of a particular State or the particular insurance accounting or reserve requirements of that State. The Committee intends that the financial condition of a risk retention group is not to be considered hazardous unless the commissioner can show that the group has not set aside adequate reserves and loss adjustment expenses sufficient to pay known claims and reasonably estimated expected claims that will be incurred during the policy period. In addition, the group should have sufficient surplus, reinsurance, or contingent reserves, or a combination of these, to assure that it can respond to highly probable excess claims.

While past claims experience modified to reflect current conditions and trends is only a rough approximation of what the actual losses of a group will be, it should be accepted (initially at least) as an indication of adequate loss reserves.¹¹ The Committee notes that "[t]here is little uniformity among insurers in the use of [methods for calculating loss reserves]."¹² Therefore, the Committee intends that the estimated loss reserves of a group should be considered adequate, unless it can be demonstrated that the assumptions or methodology involved for establishing the loss re-

¹¹ An additional indication of adequate loss reserves that may be considered is incurred but not reported losses (IBNR), based on loss development and trending of past claims.

¹² See S. Huebner, K. Black, Jr. and R. Cline, "Property and Liability Insurance," page 607 (3rd ed. 1982).

serves are materially in error or will plainly leave a group with insufficient funds to pay reasonably estimated claims that will be made against its members. Moreover, the Committee intends that any action or inquiry to determine a group's financial condition should be coordinated in a manner consistent with the National Association of Insurance Commissioners' practices for conducting zone examinations, to avoid undue administrative burdens on a risk retention group.

As noted, all these provisions regarding the authority of State insurance commissioners to enjoin the activities of risk retention groups are a response to significant concerns raised by the National Association of Insurance Commissioners at the hearing on S. 2129. It is the intent of the Committee, however, that the authority described in these provisions will be exercised in a manner consistent with the underlying policy and purposes of the Risk Retention Act. Such authority should not be exercised in a manner that would undermine or impede the interstate operation of legitimate and financially responsible risk retention groups.

In addition, the bill has been amended further by the Committee to add a new notice requirement for risk retention groups in new section 3(e) of the Risk Retention Act. This provision requires any risk retention group which intends to do business in a State other than the State in which it was chartered to furnish notice of such intention to the insurance commissioner of such State.

This notice must be furnished by certified mail. It must identify the State in which such group was chartered, state the number of members of such group in the State in which the risk retention group intends to do business, and specify the lines and classifications of liability insurance which the group intends to offer. This amendment is intended to assure that State insurance commissioners have sufficient notice to exercise their authority and to address legitimate concerns with the conduct and financial condition of risk retention groups providing coverage within their jurisdictions.

SECTION 5.—PURCHASING GROUPS

This section of the bill amends section 4 of the Risk Retention Act, which defines the scope of preemption of State law with respect to the activities of purchasing groups. It expands the application of the Risk Retention Act's exemption from specific State laws, rules, and regulations to include all "liability insurance" provided to a purchasing group or any person who is a member of a purchasing group.

In addition, this section of the bill adds to the Risk Retention Act similar language with respect to improper solicitation and sales by purchasing groups that has been added to the risk retention section. This language is contained in a new section 4(d) of the Risk Retention Act, which provides that nothing in this section shall be construed to affect the authority of any State to enjoin the following activities: (1) solicitation or sale of insurance to the public or a person who is not eligible to be a member of a group; (2) false, deceptive, or fraudulent acts or practices by an insurer, agent, or

broker in the solicitation or sale of insurance to a member of a purchasing group, or other fraudulent conduct by any such group, or its insurer, agent, or broker; and (3) the solicitation or sale of insurance to, or the operation of, a purchasing group underwritten by an insurer that is in a hazardous financial condition.

Again, this language is a response to concerns raised by State insurance commissioners at the hearing on S. 2129. The policy underlying this provision and its interpretation is intended to be consistent with that outlined above for the exercise of this authority with respect to risk retention groups. The intent of the Committee is to allow State insurance commissioners to address legitimate concerns in a manner that does not undermine or impede the overall purpose of the Risk Retention Act, which is to facilitate the operation of legitimate risk retention and purchasing groups.

SECTION 6.—REQUIREMENTS OF CERTAIN INSURANCE POLICIES

This section, which was adopted by the Committee as part of an amendment to S. 2129, adds to the Risk Retention Act a new disclosure requirement for insurance policies issued by risk retention groups. Any insurance policy issued by a risk retention group must state the following in 10-point type:

This policy is issued by your risk retention group. Your risk retention group may not be subject to all of the insurance laws and regulations of your State. State insurance insolvency guaranty funds are not available for your risk retention group.

These disclosure requirements are designed to allow a member of a risk retention group to understand better the risks of purchasing insurance from such a group. They are intended to assure that members of such groups recognize that they are assuming and spreading the liability risk exposure of the group members without another source of funds from which to pay claims.

These requirements are consistent with the policy underlying the Risk Retention Act's section 3(a)(2) exemption of risk retention groups from participation in insurance insolvency guaranty associations. As the Committee explained in its report on the Risk Retention Act (S. Rept. 97-172, page 15):

[R]isk retention groups are not full-fledged multi-line insurance companies, but limited operations. . . . [T]here will be a strong incentive for risk retention groups to set adequate premiums and establish adequate reserves if each member knows there is no other source of funds (other than its own corporate assets) from which to pay claims."

ROLLCALL VOTES IN COMMITTEE

In accordance with paragraph 7(c) of rule XXVI of the Standing Rules of the Senate, the Committee provides the following record votes during its consideration of S. 2129:

On motion to report S. 2129 with an amendment in the nature of a substitute:

YEAS—14

Danforth
Goldwater¹
Kassebaum
Pressler
Gorton
Stevens
Kasten
Trible
Hollings
Long¹
Inouye
Riegle¹
Gore
Rockefeller

NAYS—2

Ford
Exon

¹ By proxy

CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new material is printed in italic, existing law in which no change is proposed is shown in roman):

THE PRODUCT LIABILITY RISK RETENTION ACT OF 1981

SHORT TITLE

SECTION 1. This Act may be cited as the "[Product] Liability Risk Retention Act of [1981] 1986".

DEFINITIONS

SEC. 2. As used in this Act—

[(1) "completed operations liability" means liability arising out of the installation, maintenance, or repair of any product at a site which is not owned or controlled by—

[(A) any person who performs that work; or

[(B) any person who hires an independent contractor to perform that work;

but shall include liability for activities which are completed or abandoned before the date of the occurrence giving rise to the liability;]

[(2)](1) "insurance" means primary insurance, excess insurance, reinsurance, surplus lines insurance, and any other arrangement for shifting and distributing risk which is determined to be insurance under applicable State or Federal law;

[(3) "product liability" means liability for damages because of any personal injury, death, emotional harm, consequential economic damage, or property damage (including damages resulting from the loss of use of property) arising out of the manufacture, design, importation, distribution, packaging, labeling, lease, or sale of a product, but does not include the liability of any person for those damages if the product involved was in

the possession of such a person when the incident giving rise to the claim occurred;]

(2) "liability insurance" means insurance covering an organization's legal liability for damages because of injuries to other persons, damage to their property, or other loss or damage to such other persons arising out of its business, trade, products, services (including professional services), premises, or operations, but does not include (A) personal risk insurance or (B) workers' compensation and employers' liability insurance;

(3) "organization" means any association, business, corporation (whether for-profit or not-for-profit), professional corporation or partnership (including individual practitioners with respect to their business or professional activities), church, hospital, school, university, or other institution, or a State or local government (or agency of such a government);

(4) "personal risk insurance" means homeowners, tenant, private passenger non-fleet automobile, mobile home, and other liability and casualty insurance primarily for personal, family or household needs rather than for business or professional needs;

[(4)] (5) "risk retention group" means any corporation or other limited liability association taxable as a corporation, or as an insurance company, formed under the laws of any State [, Bermuda, or the Cayman Islands] —

(A) whose primary activity consists of assuming and spreading all, or any portion, of the [product liability or completed operations] liability risk exposure of its group members;

(B) which is organized for the primary purpose of conducting the activity described under subparagraph (A);

[(C) which is chartered or licensed as an insurance company and authorized to engage in the business of insurance under the laws of any State, or which is so chartered or licensed and authorized before January 1, 1985, under the laws of Bermuda or the Cayman Islands, except that any group so chartered or licensed and authorized under the laws of Bermuda or the Cayman Islands shall be considered to be a risk retention group only after it has certified to the insurance commissioner of at least one State that it satisfies the capitalization requirements of such State;]

(C) which —

(i) is chartered or licensed as a liability insurance company and authorized to engage in the business of insurance under the laws of any State; or

(ii) before January 1, 1985, was chartered or licensed and authorized to engage in the business of insurance under the laws of Bermuda or the Cayman Islands and had certified to the insurance commissioner of at least one State that it satisfied the capitalization requirements of such State, except that any such group shall be considered to be a risk retention group only for the purpose of continuing to provide insurance to cover product liability or completed operations liability (as such terms were defined in this section as in effect before the date of enactment of the Risk Retention Amendments of 1986);

(D) which does not exclude any person from membership in the group solely to provide for members of such a group a competitive advantage over such a person; and

[(E) which is composed of members each of whose principal activity consists of the manufacture, design, importation, distribution, packaging, labeling, lease, or sale of a product or products;]

(E) whose members, businesses or activities are similar or related with respect to the nature of their exposure to the risk of liability stemming from any business, trade, product, services, premises, or operations which are related, similar, or common to such members;

[(5) "purchasing group" means any group of persons which has as one of its purposes the purchase of product liability or completed operations liability insurance on a group basis; and]

(6) "purchasing group" means any group of persons—

(A) which has as one of its purposes the purchase of liability insurance on a group basis; and

(B) whose members, businesses or activities are similar or related with respect to the nature of their exposure to the risk of liability stemming from any business, trade, product, services, premises, or operations which are related, similar, or common to such members; and

[(6)](7) "State" means any State of the United States or the District of Columbia.

(b) Nothing in this Act shall be constructed to affect either the tort law or the law governing the interpretation of insurance contracts of any State, and the definitions, of [product liability and product] liability insurance and *personal risk insurance* under any State law shall not be applied for the purposes of this Act, including recognition or qualification of risk retention groups or purchasing groups.

(c) Nothing in this Act shall be construed to exempt a group authorized under this Act from the policy form or coverage requirements of any State no-fault automobile insurance law.

(d) The authority to offer or provide insurance under this Act is limited to liability insurance. This Act does not authorize a risk retention group or a purchasing group to provide coverage of any other line of insurance.

RISK RETENTION GROUPS

SEC. 3. (a) Except as provided in this section, a risk retention group is exempt from any State law, rule, regulation, or order to the extent that such law, rule, regulation, or order would—

(1) make unlawful, or regulate, directly or indirectly, the operation of a risk retention group except that the jurisdiction in which it is chartered may regulate the formation and operation of such a group and any State may require such a group to—

(A) comply with the unfair claim settlement practices law of the State;

(B) pay, on a nondiscriminatory basis, applicable premium and other taxes which are levied on admitted insurers

and surplus lines insurers, brokers, or policyholders under the laws of the State;

(C) participate, on a nondiscriminatory basis, in any mechanism established or authorized under the law of the State for the equitable apportionment among insurers of [product liability or completed operations] liability insurance losses and expenses incurred on policies written through such mechanism;

(D) submit to the appropriate authority reports and other information required of licensed insurers under the laws of a State relating solely to [product liability or completed operations] liability insurance losses and expenses;

(E) register with and designate the State insurance commissioner as its agent solely for the purpose of receiving service of legal documents or process, and, upon request, furnish such commissioner a copy of any financial report submitted by the risk retention group to the commissioner of the chartering or licensing jurisdiction;

(F) submit to an examination by the State insurance commissioner in any State in which the group is doing business to determine the group's financial condition, if [—]

[(i) the commissioner has reason to believe the risk retention group is in a financially impaired condition; and]

[(ii) the commissioner of the jurisdiction in which the group is chartered has not begun or has refused to initiate an examination of the group; [and] *any such examinations shall be coordinated to avoid duplication and unjustified repetition; and*

(G) comply with a lawful order issued in a delinquency proceeding commenced by the State insurance commissioner if [the commissioner of the jurisdiction in which the group is chartered has failed to initiate such a proceeding after notice of] *there has been a finding of financial impairment under subparagraph (F) of this paragraph;*

(2)-(4) * * *

(b) The exemptions specified in subsection (a) apply to—

(1) [product liability or completed operations] liability insurance coverage provided by a risk retention group for—

(A) such group; or

(B) any person who is a member of such group;

(2) the sale of [product liability or completed operations] liability insurance coverage for a risk retention group; and

(3) the provision of insurance related services or management services for a risk retention group or any member of such group.

(c) * * *

(d) *Nothing in this section shall be construed to affect the authority of any State to enjoin—*

(1) *the solicitation or sale of insurance by a risk retention group to the public or any person who is not eligible for membership in such group;*

(2) false, deceptive or fraudulent acts or practices in the solicitation or sale of insurance to a member or a prospective member of a risk retention group, or other fraudulent conduct by any such group; or

(3) the solicitation or sale of insurance by, or the operation of, a risk retention group that is in a hazardous financial condition.

(e) Any risk retention group which intends to do business in a State other than the State in which it was chartered shall furnish notice of such intention to the insurance commissioner of such State. Such notice shall—

(1) be furnished by certified mail;

(2) identify the State in which such group was chartered;

(3) state the number of members of such group in the State in which the risk retention group intends to do business; and

(4) specify the lines and classifications of liability insurance which the risk retention group intends to offer.

PURCHASING GROUPS

SEC. 4. (a) * * *

(b) The exemptions specified in subsection (a) apply to—

(1) [product liability or completed operations liability insurance, and comprehensive general] liability insurance [which includes either of these coverages,] provided to—

(A) a purchasing group; or

(B) any person who is a member of a purchasing group; and

(2) the provision of—

(A) [product liability or completed operations insurance, and comprehensive general] liability coverage;

(B) insurance related services; or

(C) management services; to a purchasing group or member of the group.

(c) * * *

(d) Nothing in this section shall be construed to affect the authority of any State to enjoin—

(1) the solicitation or sale of insurance by an insurer, agent or broker to the public or any person who is not eligible for membership in such group;

(2) false, deceptive or fraudulent acts or practices by an insurer, agent or broker in the solicitation or sale of insurance to a member or a prospective member of a purchasing group, or other fraudulent conduct by any such group or its insurer, agent or broker; or

(3) the solicitation or sale of insurance to, or the operation of, a purchasing group underwritten by an insurer that is in a hazardous financial condition.

APPLICABILITY OF SECURITIES LAWS

SEC. 5. * * *

REQUIREMENTS OF CERTAIN INSURANCE POLICIES

SEC. 6. *Any insurance policy issued by a risk retention group shall state the following in 10-point type:*

This policy is issued by your risk retention group. Your risk retention group may not be subject to all of the insurance laws and regulations of your State. State insurance insolvency guaranty funds are not available for your risk retention group.

ADDITIONAL VIEWS OF MR. GORTON

Although I voted to report this bill to the Senate floor, I must express my serious reservations about the possible consequences of enacting the bill in its current form.

I have no quarrel with the proposition that classes of people or businesses which have been denied liability coverage at reasonable rates by the conventional insurance market should be provided some opportunity to self-insure. I also appreciate the fact that economies of scale may make it unrealistic to expect some of these groups to license separately with every State in which they intend to do business. Nonetheless, I cannot make the leap of logic that a bill drafted to provide that opportunity must be drafted so broadly that groups which are quite capable of meeting the regulatory requirements of the several States need not do so and may even charter in a State in which they have no members. What justification can we provide to the public for groups which could and would otherwise operate in a system, already criticized by some as inadequate, being permitted to operate with even less oversight?

The bill as it came before the Committee for mark-up was so permissively drawn that it would have allowed a group to charter in a State in which it had no members and operate in the remaining 49 without even notifying the insurance commissioners of those States that it was so operating. Adequate regulation of known entities is difficult enough, but can we expect the insurance commissioners to regulate groups about which they have no knowledge? I think not. For that reason, I offered an amendment at the mark-up to require such notification. But that does not resolve my uneasiness with this bill.

An example of the potential for disaster under this bill appeared in the Washington Post on April 6, 1986. The Post article described the demise of a Maryland insurance company, Eastern Indemnity, which provided bonds to small contractors on public and private projects. The company collapsed in 1984, leaving only \$1 million in real assets while facing nearly \$70 million in claims as a result of problems on 800 construction projects in 32 States and the District of Columbia. The Post article went on to say that:

Eastern won waivers around the Nation to expand more rapidly than normally allowed, ducked Maryland's requirements for the establishment of adequate reserves and wrote financial reports that made the company appear more stable than it was, according to an examination of Eastern's financial reports, correspondence with the insurance division and dozens of interviews.

In short, it ran rings around the regulatory system that is intended to protect the public by detecting and preventing insolvencies

Eastern Indemnity could qualify as a risk retention group under the bill as reported by the Committee. As a result, many of the activities of Eastern described by the Post as "running rings around the regulatory process . . ." would instead be in complete accord with the regulatory process. And, those activities which still violated the regulatory process would be less likely to be discovered than under the current system. Indeed, this would be an almost certain result if the group chartered in a State in which it had no members. At least in the case of Eastern Indemnity, the State of Maryland had a substantial interest in protecting its citizens.

I have seen several commentaries on the bill which take solace in the fact that a risk retention group may not solicit membership from the general public. I take no such solace from that fact, for who are the members of the group before they become members other than the public? Organizers of a group may choose to solicit membership from small daycare centers, pesticide applicators, fishermen, apartment building owners, dentists or any other class with a relatively large and not well organized membership. Surely, if organizers of a risk retention group were to start soliciting membership from owners of apartment buildings in the United States, they would be soliciting membership from members of the public.

Moreover, not every group formed under this bill will have a well defined and previously indentified pool of potential members as do the nurse mid-wives. Nor will these groups necessarily be self-organizing. They may well be organized by profit-motivated outsiders with no personal interest in the proper functioning of the risk retention group.

The organizers of such a group could solicit membership in any State, other than the State of charter, without any review of the adequacy of the rates charged. A group competing for the same business as licensed insurers may very likely underprice coverage in order to lure insureds away from the conventional market. The underpricing of coverage is the very practice that many of the proponents of this legislation assert as a cause of the current "liability insurance crisis". If that is the case, why are we creating a system which not only permits that practice but would encourage it, particularly among groups inexperienced and small enough to have difficulty recovering from the effects of such underpricing?

Additionally, I understand that the proponents of this bill intend the coverage provided by a risk retention group to constitute "proof of insurance" for the purpose of complying with State and Federal regulatory statutes requiring such coverage before engaging in a hazardous activity such as the application of pesticides to the land of another. I find no justification for telling States that they must accept such coverage as appropriate under their regulatory schemes where other public policy considerations are at work. Such requirements of proof of insurance are usually intended not for the benefit of the licensee, but for the benefit of third parties who may be injured by the licensee's activities. It is not appropriate for the Federal Government to preempt the State's judgment of what is the proper minimum level of protection for its citizens against the perils of hazardous activities conducted within the State. Nor am I comfortable with groups with direct regulation by only one State

being deemed adequately covered for the performance of activities requiring proof of insurance as a matter of Federal law.

I heard no member of the Committee dispute the fact that it is appropriate to provide relief to the nurse mid-wives or local governments. Nor do I. But I do dispute the fact that in so doing we need to create a parallel and largely unregulated insurance market to insure risks for which insurance is currently available under reasonable terms and conditions. That is neither fair to existing insurance companies, potential insureds or the third party beneficiaries of the insurance contracts. I hope that the sponsors of this bill will consider modifications to it which will result in its achievement of its stated purpose, no less than that, and, as importantly, no more. Without such additional modifications, I cannot support it.

SLADE GORTON.

MINORITY VIEWS OF MR. FORD

When Congress enacted the Risk Retention Act of 1981, its recognized the harm that could be done by a broad law preempting the State regulatory structure. Since 1945, the States have had primary responsibility for protecting consumers from unsound insurance practices and insolvent insurance companies. The Risk Retention Act provided an outlet for manufacturers and others who were unable to secure affordable product liability insurance without interfering with State regulation in other insurance lines.

Now the Committee on Commerce, Science, and Transportation proposes to expand the Risk Retention Act to all lines of commercial liability insurance. I understand the Committee's decision to write a broad bill. The Congress is under pressure to respond to constituents' complaints that liability insurance has become costly and in some cases, unobtainable. There are several groups that have found that obtaining liability insurance is impossible even though they do not have a bad claims record. Several examples of these groups are nurse-midwives, municipalities, and day care centers.

The nurse-midwives present a particularly hard case. Without insurance, they cannot pursue their profession and in my State, nurse-midwives provide a very valuable service. Nurse-midwives serve many parts of eastern Kentucky which do not have other forms of medical service available and they also provide service to low income patients. Despite relatively few actual claims, reinsurance for nurse-midwives malpractice coverage has dried up and their premiums have risen prohibitively. Nurse-midwives will, in some cases, fill a void being left by obstetricians abandoning the practice in the face of huge malpractice awards. Nurse-midwives believe that S. 2129 is necessary to solve their crisis and they need the bill enacted promptly.

I suggested during Committee deliberations that we report a bill immediately which specifically enables the nurse-midwives and other aggrieved groups to form risk retention groups. The Committee decided to report a bill for all lines of commercial liability insurance with the agreement that efforts would be made to improve the bill.

Although the Committee intends to allow risk retention groups to form and operate in troubled insurance lines, the bill goes further. S. 2129, as reported, allows any risk retention group in any line of commercial liability insurance. S. 2129 will establish a parallel unregulated insurance industry. Even with State regulation, nearly 50 insurance companies have failed in recent years. Completely deregulating all lines of liability is simply not the answer to the insurance crisis.

The pressure upon State legislatures and insurance commissioners to provide relief for insurance consumers is even more intense

than the pressure on Congress. Remedial measures are being pursued in every State. If the Committee wishes to supplement the response by State regulators, we ought to preserve as much State regulatory protection of insurance commissioners for the benefit of injured parties as possible. This includes the ability of the State insurance commissioners to know the financial condition of the risk retention group operating in their State, even if the risk retention group is chartered in another State. State regulatory protection should also include the ability of a State insurance commissioner to proceed with an injunction in a court of competent jurisdiction should a hazardous financial condition or a financially impaired condition be found in a risk retention group. Consumer protection should not be overlooked in this attempt to ease the insurance crisis.

WENDELL H. FORD.

○

OPERATING RIGHTS AT CONGESTED DOMESTIC AIRPORTS

MAY 14 (legislative day, MAY 12), 1986.—Ordered to be printed

Mr. DANFORTH, from the Committee on Commerce, Science, and Transportation, submitted the following

REPORT

[To accompany S. 1966]

The Committee on Commerce, Science, and Transportation, to which was referred the bill (S. 1966) to provide for efficient and equitable use of operating rights at congested airports, and for other purposes, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill do pass.

PURPOSE OF THE BILL

S. 1966, as reported, would require the Secretary of Transportation (the Secretary) and the Administrator (the Administrator) of the Federal Aviation Administration (FAA) to repeal a Department of Transportation (DOT) final rule which allows the purchase and sale, leasing, and trading of air carrier and commuter airline operating rights (slots) at the nation's high-density airports: Washington National, Chicago O'Hare, and New York's Kennedy and LaGuardia. The bill would require the Administrator to issue an alternative rule to ensure the efficient and equitable use of operating rights at the four airports.

BACKGROUND AND NEEDS

THE PROBLEM

Beginning in approximately 1969, limited air traffic control (ATC) capacity and/or a lack of sufficient airport runway capacity have constrained air carrier, commuter operator, and general aviation operating rights under instrument flight rule (IFR) conditions

at the nation's busiest airports. ("Air carrier operations" are those conducted by air carriers with aircraft having a certificated maximum passenger seating capacity of 56 or more. "Commuter operators" are air carriers with aircraft seating less than 56.) With a view to mitigating this problem at four of those airports—National, Kennedy, LaGuardia and O'Hare—the Federal Aviation Administration (FAA) imposed maximum hourly totals for IFR operations at each airport, under the so-called "High Density Rule" (14 CFR 93.121 et seq.). The High Density Rule specifies how many slots may be used by each category of aircraft operator at the four airports. A slot may be used for either one arrival or one departure.

For many years slots at the high-density airports have been allocated among air carriers and commuter operators by scheduling committees, each of which is composed of airlines that operate, or wish to operate, at one of the four airports. The scheduling committees operate under a grant of antitrust immunity—first authorized by the Civil Aeronautics Board and now authorized by DOT—pursuant to section 414 of the Federal Aviation Act of 1958. Under existing rules, a scheduling committee must reach unanimous agreement on slot allocations. When it fails reach agreement it may, if its members unanimously agree to do so, vote to declare an impasse, and thereby invite FAA intervention to break the deadlock.

Scheduling committees at some or all of the four airports have been deadlocked for some time. The Washington National scheduling committee first deadlocked in 1980; it has now been deadlocked since 1983. The result has been a closed door at the airports, with would-be new entrants excluded and frustrated in their attempts to gain entry to these lucrative markets.

There are several reasons for this impasse. The first is the absence of an effective "use-it-or-lose-it" rule, a rule which would require air carriers and commuters to use their slots or relinquish them. The second is the absence of an effective "deadlocked-breaking mechanism," a procedural device which would encourage scheduling committees to reach agreement among themselves or, failing to do so, have their slots reallocated by FAA administrative mechanism. The last is the requirement of unanimity of carrier action before a scheduling committee can act.

The problem of unused slots bears further discussion. There are at least two reasons for an airline to "pocket" slots: first, to prevent a competitor from using them, and second, to hoard them for the day when buying and selling is permitted, when the new "owner" can sell its new "asset" for cash. Whatever the motive, the result is the same: new entrants are excluded from gaining airport access. The only good thing that can be said about slot hoarding is that the problem is universally recognized. Air carriers, airports, DOT and this Committee are in agreement that a "use-it-or-lose-it" rule would be both simple to implement and simple to monitor.

The issue of an appropriate deadlocked-breaking mechanism is less susceptible of easy analysis. While the objective of such a mechanism is readily apparent—the creation of an incentive for scheduling committees to reach agreement and a mechanism to reallocate slots if they do not—how to accomplish that objective is less obvious. Over time a number of different mechanisms have

been suggested and discussed, in every conceivable forum. The suggestions have included slot lotteries, auctions, formula-allocation approaches, and purchase and sale. Each method alone offers certain benefits and certain liabilities. What some offer in the way of efficiency gains they give up in rewarding the fact of incumbency. What others provide in fairness and lack of bias is made less attractive by their randomness. While some commentators advocate the adoption of the most irrational of mechanisms—presumably to provide the greatest incentive for airlines to reach agreement in scheduling committees—more balanced approaches offer the advantage of providing both an incentive to agree, and an equitable allocation scheme. It is this latter approach which the Committees has attempted to incorporate in this legislation.

RECENT SENATE CONCERN

On June 7, 1984, DOT issued two notices of proposed rulemaking which address the slot issue. The first, Docket No. 24105, Notice 84-6, proposed to remove government restrictions on slot transfers and allow slot exchanges for consideration. The second, related proposed rule, Docket No. 24110, Notice 84-7, set forth a procedure to be used if a scheduling committee was unable to allocate newly available slots.

The rulemaking was unconcluded for some 18 months. During its pendency, slot hoarding by airlines—which may have anticipated the imminent right to sell slots for cash—increased. By December 1985, some estimated that as many as 3-7 percent of the approximately 4,225 allocated total slots at the 4 airports were pocketed.

Because of various expressions of congressional concern regarding the rulemaking, carriers and Senators alike believed that the rule would never be finalized. However, in early December 1985, it became increasingly apparent that DOT intended to issue a rule which would allow the purchase and sale of slots. Concerned at this prospect, on December 3, 1985, seven members of the Committee wrote to the Secretary urging her to delay issuing any rule which would allow slot buying and selling until such time as the Committee had an opportunity to review the effect of a "buy-sell" policy on the traveling public. The Committee also urged the Secretary to issue an immediate rule requiring carriers to use their slots or lose them. (That letter is printed in its entirety in the Appendix to this reports.) On December 20, 1985, DOT issued a final rule which would allow the purchase and sale of slots.

THE RULE

The final rule, designated "High Density Traffic Airports Slot Allocation and Transfer Methods" (50 Federal Regulation 52180, December 20, 1985) is extremely detailed. Among other things, it provides: (1) Effective April 1, 1986, slots at the four airports may be purchased, sold, traded or leased; (2) air carriers and commuter operators holding slots on December 17, 1985, will be allocated those slots ("grandfathered"); (3) slots not presently in use will be made available to airlines by lottery, with preference given to new entrants; (4) separate slot pools will be maintained for commuters and air carriers at each high-density airport. Commuters will be able to

use commuter and air carrier slots, but air carriers will be restricted to air carrier slots. General aviation will continue to receive its present allocation; (5) slots must be used 65 percent of the time during a two-month period or they will be withdrawn by the FAA for reallocation; and (6) Essential Air Service (EAS) and international slots are guaranteed, and cannot be transferred. Slots may be withdrawn from domestic carriers if there are insufficient slots to accommodate EAS and international carriers.

In addition to this rule, DOT simultaneously issued a Notice of Proposed Rulemaking (Docket No. 24105, Notice No. 85-25) to provide for the initial withdrawal of up to 5 percent of the slots used by air carrier and commuter operators at the high density airports by lottery, and for their redistribution to other air carriers and commuter operators, also by lottery.

In considering the issues raised by the rulemaking, the Commerce Committee held a hearing to discuss some of those questions. On February 6, 1986, witnesses representing the Nation's airports, State aviation officials, aviation consumer groups, air carriers, general aviation manufacturers, pilots, and others, all came forward to express their concerns about the implications of DOT's rule. Their valuable testimony was of great assistance to the Committee in focusing on some of the rule's major shortcomings.

While some aspects of the new rule are unobjectionable, for example, the use-or-lose provision, in the Committee's view the rule's underlying premise is flawed. "Buy-sell" purports to embody the theory of the marketplace, that is, where a resource is scarce, market forces will allocate it most efficiently. What supporters of the rule overlook, however, is that market theory breaks down in a market which is physically closed to new entrants. It is clear that the optimal solution to the problem of access to high-density airports is to create new opportunities for entry by creating additional airport capacity. Until that occurs, however, someone will regulate entry. Here the choice of regulators is limited to incumbent carriers and the Government. In the Committee's view, a benign government is better positioned to structure and supervise an equitable system of allocation than are incumbent airlines intent on maintaining market share.

While supporters of the concept argue that buy-sell will allow entry into closed markets to be purchased, the Committee is fearful that incumbent carriers may have an incentive to keep even those slots which they cannot use efficiently, rather than sell or lease them to a potential competitor. Rather than being consistent with airline deregulation, as its proponents maintain, buy-sell perpetuates 40 years of airline regulation. A majority of the incumbent airlines obtained today's valuable slots as part of route awards under Federal regulation, prior to 1978. DOT's rule would allow those incumbents not only to go on using those landing rights indefinitely, but to sell them as well.

In the Committee's view, to grandfather incumbents into existing slots, as does the present rule, creates a windfall for those carriers fortunate enough presently to hold slots. It does so by converting a public property interest—the right to use a segment of time in the national airspace system—into private property, to be sold at will. While the rule's proponents argue that incumbent carriers enjoy a

windfall today, insofar as they already use a limited resource without charge, the Committee takes the position that the right merely to use a public asset, even without cost, is considerably less valuable than being able to convert such an asset into cash at will. Moreover, to oblige those carriers not so fortunate as to possess slots today to buy slots from incumbents, some of which may be true oligopolists, creates a barrier to entry which is inconsistent with any notion of a deregulated aviation environment.

The Committee also is concerned that air service to small and medium-sized communities (not including EAS points) may suffer under the present rule. The Committee finds credible the argument that once an airline has paid a premium price for a slot, it will have an additional incentive to serve large, high-density markets, to increase load factors, and to recoup thereby the cost of the slot. This argument finds support in history. During 1982, when the FAA temporarily allowed the purchase and sale of slots, transactions occurred wherein predominantly small carriers sold slots to predominantly large carriers, slots which in many instances the small carriers had used to provide service to small-to-medium-sized communities. Again, in many cases the larger, purchasing carrier used the slot to serve larger, more lucrative markets. The result was reduced service for smaller communities, many of which find their only practical access to the national air transportation system in service to high-density airports. The Committee shares the view that these small cities deserve at least the same chance of access to these high-density hubs as larger cities, which can provide more profitable service to them.

While the Committee has many more concerns about the likely impact of the present rule, two bear special mention. The first has to do with the spread of the high-density problem. While DOT's rule will apply to only 4 airports today, FAA projects that in 4 years 32 airports will require some slot restrictions and that by the end of the century that number will reach 61. With the rule's broader application will come the burgeoning of the problems described above.

The second problem has to do with the very objective which all the parties interested in this matter share: the creation of airport capacity sufficient to dispense with the High Density Rule altogether. The question must be asked why a major incumbent carrier at one of the four high-density airports would, after obtaining a number of valuable slots, vote to approve a capacity-increasing airport development project. Increasing capacity dilutes the value of existing slots. Will incumbents be willing to see the value of their slots diluted and vote for vitally important capacity-expansion projects? If this rule's duration is not limited, time will tell.

THE LEGISLATION

On December 17, 1985, one day after the rule's issuance, Senator Kassebaum, the chairman of the Aviation Subcommittee, joined by Senator Danforth, the chairman of the Commerce Committee, Senator Hollings, the ranking minority member, Senator Exon, the subcommittee's ranking member, and 12 other Senators, introduced S. 1966, legislation to require DOT to repeal the buy-sell rule.

As originally introduced, S. 1966 merely required DOT to repeal the rule; to issue no new rule inconsistent with the bill; to immediately impose a "use-it-or-lose-it" requirement on airlines at the high-density airports; and to equip the scheduling committees with an effective deadlock-breaking device. The bill subsequently was reworked to specify with greater particularity the kinds of deadlock-breaking mechanisms which the Committee believed the Administrator should consider, and to require the FAA to review periodically the continued need, if any, for the High Density Rule at any airport. It is this latter version which the Committee subsequently reported.

LEGISLATIVE HISTORY

S. 1966 was introduced by Senator Kassebaum and 15 cosponsors on December 17, 1985. On February 6, 1986, the Aviation Subcommittee held a hearing on the legislation. On March 13, 1986, the Commerce Committee ordered the bill reported with an amendment in the nature of a substitute, by a vote of 15 to 1.

SUMMARY OF MAJOR PROVISIONS

As reported, S. 1966 would:

1. Require DOT to repeal the final rule regarding slot allocation issued on December 20, 1985, and to issue no new rule allowing the purchase and sale of slots;
2. Require FAA to issue a new rule which includes a "use-or-lose" provision, requiring airlines to use the slots they now hold or relinquish them for reassignment;
3. Require FAA to issue a new rule creating a deadlock-breaking mechanism for scheduling committees. The bill specifies in general terms some of the types of mechanisms which would be acceptable. Buying and selling slots would be prohibited;
4. Provide that the proceeds derived from any deadlock-breaking mechanism involving the leasing of slots by FAA be deposited in the Aviation Trust Fund;
5. Require FAA to formulate a mechanism to allocate all new slots, voluntarily returned slots, and unused slots;
6. Provide that slots remain the property of the FAA, and may be withdrawn at will;
7. Require the FAA to provide at least 90 days notice to Congress of any intention to impose slot restrictions at any other airport, other than on an emergency basis; and
8. Require the FAA to review the continued need (if any) for the high density rule at least every 2 years, and to justify its retention to Congress.

ESTIMATE COSTS

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate and section 403 of the Congressional Budget Act of 1974, the Committee provides the following cost estimate, prepared by the Congressional Budget Office:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 3, 1986.

Hon. JOHN C. DANFORTH,
*Chairman, Committee on Commerce, Science and Transportation,
U.S. Senate, Dirksen Senate Office Building, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 1966, a bill to provide for efficient and equitable use of operating rights at congested airports, and for other purposes, as ordered reported by the Senate Committee on Commerce, Science, and Transportation, March 13, 1986. We expect that enactment of this bill would result in no significant cost to the federal government, and in no cost to state and local governments.

The bill repeals a December 20, 1985 final rule issued by the Department of Transportation (DOT), which would allow the purchase and sale of landing and takeoff slots by air carriers at the four high-density airports: Washington National, Chicago O'Hare, and New York's Kennedy and LaGuardia Airports. The rule, which took effect April 1, 1986, is intended to replace the use of scheduling committees that have been making slot allocation decisions at each of these airports. Instead, S. 1966 requires DOT to establish certain rules to improve the scheduling committee method of slot allocation. These include the recall of any slots that are substantially unused, special mechanisms for resolving scheduling committee deadlocks, and biennial reauthorization or elimination of all high-density traffic airport slot controls.

Under DOT's December 20 rule, the government would not receive any income from the allocation of slots, though holders of the slots would be able to sell them to others. Under S. 1966, the government would also not receive any income from the allocation of slots, if the scheduling committees are able to reach agreement. If not, mechanisms to be established by the Federal Aviation Administration (FAA) would be used for the allocation. Such mechanisms could include leasing the slots, which would result in receipts to be deposited in the Airport and Airway Trust Fund. Thus, S. 1966 could result in additional receipts if the leasing of slots were to occur—but there is no basis for projecting whether such leasing would be implemented and what receipts would be generated.

Administrative and enforcement activities associated with the bill's rule-making provisions could cost between \$500,000 and \$1.5 million annually, depending on the approach adopted by the FAA. Costs in the first year would be slightly higher. If the FAA chooses to make use of leasing and auctions, annual costs will likely be at the higher end of this range. These costs, however, could be offset by additional trust fund receipts from leasing slots.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,
Sincerely,

RUDOLPH G. PENNER, *Director.*

REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee provides the following evaluation of the regulatory impact of the legislation, as reported.

The bill would require the repeal of a rule. The net effect of such repeal would be a substantial reduction of regulatory burden on airlines. The bill also would direct FAA to promulgate a new rule requiring airlines to use slots or lose them. This provision poses no regulatory burden which does not exist today.

The legislation's requirement that the Administrator formulate a deadlock-breaking mechanism for scheduling committees likewise imposes no regulatory burden. The FAA has already developed a massive record regarding the functionality of the various mechanisms under consideration.

The bill requires FAA to review periodically the continued need for any High Density Rule and report to Congress. Insofar as FAA is constantly reviewing the need for airport slot restrictions, this requirement, too, poses no significant burden for FAA.

The legislation would impose no new costs on any person. Whether airlines might be obliged in the future to pay the government for airport slots is dependent on the deadlock-breaking mechanism formulated by FAA.

There will be no effect on the personal privacy of individuals due to enactment of the legislation. No significant new paperwork burdens would be placed on any person if S. 1966 were enacted into law.

SECTION-BY-SECTION ANALYSIS

SECTION 1.—REPEAL OF RULE

This section requires the Secretary and the Administrator to repeal the final rule regarding Slot Allocation and Transfer Methods at the High Density Traffic Airports, issued on December 20, 1985 (50 Federal Regulations 52180), and, after the bill's enactment, issue no rule, except on an emergency basis, inconsistent with the provisions of the act. Any rule allowing the purchase and sale of slots would, in the Committee's view, be inconsistent with the provisions of the act.

SECTION 2.—“USE OR LOSE” RULE

Section 2 requires the Administrator to act within 120 days of the bill's enactment to recall and reallocate slots which are substantially unused, except that the requirement shall not apply to international slots or EAS slots. The requirement extends to both air carriers and scheduled commuter operators. In determining which slots are “substantially unused,” the Committee would urge the Administrator to adopt a standard no less strict than that contained in section 93.227 of the rule issued December 20, 1985 (50 Federal Regulations 52180).

SECTION 3.—DEADLOCK-BREAKING MECHANISM

This section directs the Administrator to establish, by rule or otherwise, after considering public comment, an equitable mechanism for slot allocation in the event that scheduling committees are unable to agree. The retention of scheduling committees is expressly provided for, and while the Committee does not specify the composition of the scheduling committees, it fully expects that the committees will be fairly constituted with equal representation for all members. Likewise, although the Committee does not specify the time schedule which the Administrator must establish for scheduling committee activities, it contemplates that allocation and reallocation functions will occur no less regularly than they do today.

In directing the Administrator to create a deadlock-breaking mechanism, the Committee identifies some of those devices which it believes would be appropriate (binding arbitration, lottery, leasing), but leaves open the possibility of fashioning some other kind of non-market mechanism. (In excluding market mechanisms, the Committee intends to exclude expressly the buying and selling of slots as an allocation method.) This open-ended directive should not, however, be used to subvert the Committee's intent. The Committee would take great exception to a deadlock-breaking mechanism which, for instance, allowed the Administrator to lease a slot for \$1 per year, with no restraints on subleasing.

Other Committee expectations with regard to considerations which should be factored into the creation of the mechanism are expressly described in section 3. No mechanism shall remain in effect after December 31, 1988, the date on which DOT's authority to provide antitrust immunity is statutorily terminated.

Finally, the section provides that any revenues generated by the leasing of slots shall be credited to the Aviation Trust Fund. It also provides that any method for the withdrawal of slots shall ensure that no carrier incurs the loss of an undue proportion of its slots. In the Committee's views, 5 percent of any airline's slots is not an "undue proportion," but in withdrawing slots the Administrator should take into account the capital investment of existing users.

SECTION 4.—SLOTS AS OPERATING PRIVILEGES

This section provides that whatever deadlock-breaking mechanism the Administrator fashions, slots shall not be constructed to constitute permanent property rights. Slots are public property and their use shall represent a non-permanent operating privilege within the exclusive control of the Administrator.

SECTION 5.—HIGH DENSITY RULE

This section is premised on the Committee's strong belief that the need for any kind of slot restrictions at the Nation's airports is regrettable. The Committee is committed to the expansion of airport capacity consistent with consumer demand. To this end, subsection (a) provides that except on an emergency basis, the Administrator shall not extend slot restrictions to any other airport—including Newark International—without providing at least 90 days

notice to the Congress. The FAA projects that, by 1990, 32 airports will need some kind of slot restrictions. While the Committee has no intention of interfering with FAA safety determinations, it does intend to review carefully FAA's justification for subjecting additional airports to slot restrictions. The necessity for an exception to this provision to allow the Administrator to respond to emergencies is so obvious as to hardly need reiteration.

Subsection (b) requires the Secretary to reauthorize the High Density Rule, as it exists today, every 2 years. The periodic rule-making required by this section will give the aviation community and the Congress regular opportunities to review the need for the rule's perpetuation. The requirement that reports mandated by this section describe capacity-enhancing improvements is intended to focus the Committee's attention on how best to allocate scarce financial resources.

SECTION 6.—ADDITIONAL STATUTORY AUTHORITY

This section merely provides that the Secretary and the Administrator may seek any additional, related statutory authority from the Congress at any time. The section also provides that the Secretary and the Administrator shall report annually to the Congress on how this legislation has minimized barriers to entry at the Nation's high-density airports.

ROLLCALL VOTES IN COMMITTEE

In accordance with paragraph 7(c) of rule XXVI of the Standing Rules of the Senate, the Committee provides the following record votes during its consideration of S. 1966:

On the motion to report S. 1966 with an amendment in the nature of a substitute:

YEAS—15

Mr. Danforth
Mr. Goldwater ¹
Mrs. Kassebaum
Mr. Pressler
Mr. Stevens ¹
Mr. Kasten
Mr. Tribble
Mr. Hollings
Mr. Long ¹
Mr. Inouye
Mr. Ford
Mr. Riegle ¹
Mr. Exon
Mr. Gore ¹
Mr. Rockefeller

NAYS—1

Mr. Gorton

¹ By proxy.

CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, the Committee states that the bill as reported would make no change to existing law.

APPENDIX

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC, December 3, 1985.

The Honorable ELIZABETH H. DOLE,
Secretary, Department of Transportation,
Washington, DC.

DEAR SECRETARY DOLE: We understand that the Department of Transportation (DOT) may be about to issue a final rule in DOT dockets 24110 and 24105 which would allow air carriers to purchase and sell ("buy-sell") landing rights ("slots") at the nation's four "high-density rule" airports. This concerns us greatly. We would ask that you defer any final action which would allow the purchase and sale of slots until the Commerce Committee can exercise its responsibility to examine and act on this complex issue. It is the Aviation Subcommittee's intention to review this issue in hearings at the earliest possible date in the next Congressional session.

We agree that the status quo at the high-density rule airports is unacceptable. The scheduling committees have proven themselves unable to address effectively the exclusion of new airline entrants, or the reallocation of slots among incumbents. In the absence of incentives to agree—created in part by the pendency of this very rulemaking—the committees have essentially worsened the very problem which they were intended to remedy.

We do not believe, however, that the solution to one problem lies in the creation of a more serious one. We have real doubts as to whether the long-term interests of the aviation industry and the traveling public will be best served by buying and selling airport landing rights. Among our many concerns are these: Is it good policy to allow private air carriers to obtain a public property right, such as an airport slot, at no cost? Is it equitable to provide such windfalls to incumbents exclusively, or almost exclusively? Assuming buy-sell were to be implemented, would not competition best be served by requiring that a significant number of existing slots be distributed initially to new entrants, or at least redistributed among incumbents, perhaps through a lottery or auction mechanism? How would buy-sell protect the legitimate rights of mid-size communities to undiminished, affordable air service? Wouldn't buy-sell, by putting a price on slots, a limited commodity, create a disincentive to produce additional airport capacity, because incumbents will be unwilling to see the value of their slots diluted? Doesn't converting slots into property rights invite litigation against the Federal Aviation Administration, as it attempts to exercise reasonable control over slots?

In view of these and other concerns, we strongly urge the Administration to issue a "use or lose" slot policy for carriers at the capacity-constrained airports in Chicago, New York and Washington, effective at least until such time as the Committee has the opportunity to review the effects of a buy-sell policy on the traveling public. Such a rule would go far towards eliminating the problem of carriers "pocketing" unused slots. The Department should also impose a deadlock-breaking mechanism on the scheduling committees, to remedy the unacceptable situation which presently exists at the high-density rule airports, and thereby make it possible for new entrants to gain reasonable access to those markets.

Madam Secretary, the purchase and sale of airport slots, as it is presently being discussed, will have severe and dramatic effects on commercial aviation in this country for years to come. Careful review is therefore warranted. In the event that any final rule other than that discussed in the preceding paragraph is issued before we have had an opportunity to examine its full effect, we must insist that it not become effective before we can review it, which we commit to do at the earliest possible date. That failing, we will have no option but to consider legislative action to delay the rule's implementation.

Sincerely,

ERNEST F. HOLLINGS.
NANCY LANDON KASSEBAUM.
J. JAMES EXON.
WENDELL H. FORD.
DANIEL K. INOUE.
JOHN D. ROCKEFELLER IV.
LARRY PRESSLER.

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